UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

MARK NEWBY, et al., Individually and On Behalf of All Others Similarly Situated,	§	Civil Action No. H-01-3624
	§	**(Consolidated)**
	§	
Plaintiffs,	§	CLASS ACTION
vs.	§	
ENRON CORP., et al.,	§	
Defendants.	§	

AMALGAMATED BANK'S *EX PARTE* APPLICATION FOR PARTICULARIZED EXPEDITED DISCOVERY FROM DEFENDANT ARTHUR ANDERSEN LLP TO PRESERVE EVIDENCE

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MEMORANDUM OF POINTS AND AUTHORITIES

I. THE IMPACT OF ARTHUR ANDERSEN'S ADMISSION

In a block-buster development in the Enron meltdown – so explosive that it dominated the network newscasts, preempted coverage of the war in Afghanistan, and was featured on the front pages of major newspapers – defendant Arthur Andersen has admitted that it does not know if or when it violated its duty to preserve relevant evidence. Enron's outside auditor

> notified the U.S. Securities and Exchange Commission and the U.S. Department of Justice, and is also notifying congressional committees and other agencies investigating the Enron collapse, that ***in recent months*** individuals in the firm involved with the Enron engagement ***disposed of a significant but undetermined number of electronic and paper documents and correspondence relating to the Enron engagement.***
>
> * * *
>
> Discarding of documents occurred during the months before the SEC issued a subpoena to Andersen. After receiving the SEC subpoena, the firm issued an instruction to preserve documents. ***At this time, we have not been able to determine whether that instruction was violated.***
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> * * *
>
> The firm is working to gather the facts and determine appropriate disciplinary actions.[1]

Joining congressional committees, executive-branch criminal probes, political and legal commentators, Amalgamated Bank urges the Court to order Andersen, through plaintiff's particularized discovery, to answer questions integral to the litigation: Who shredded the documents? Which ones? When? On whose orders? And why?

The PSLRA's document-preservationprovisions make it "illegal for any party who receives actual notice of the litigation to destroy or alter evidence."[2] Indeed, courts have consistently allowed discovery to commence "when faced with 'the risk of lost or destroyed evidence.'"[3] The

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[1]Arthur Andersen Press Releases, dated January 10, 2002, attached hereto as Ex. 1; *see also* J.Weil et al., "Audit Nightmare: Arthur Andersen Says it Disposed of Documents that Relate to Enron," *Wall St. J.*, Jan. 11, 2002 (Ex. 2); K. Eichenwald et al., "Enron's Collapse: The Auditor - Enron's Auditor Says it Destroyed Documents," *N.Y. Times*, Jan. 11, 2002 (Ex. 3).

[2]*Powers v. Eichen*, 961 F. Supp. 233, 235 (S.D. Cal. 1997).

[3]*See, e.g., Vezzetti v. Remec, Inc.*, No. 99CV0796-L (JAH), 2001 U.S. Dist. LEXIS 10462, at *5 (S.D. Cal. July 20, 2001) (citation omitted).

PSLRA stays discovery during the pendency of a motion to dismiss, but Congress "included a preservation provision in the PSLRA 'in recognition that "the imposition of a stay of discovery may increase the likelihood that relevant evidence may be lost."'"[4] As such, the "statute provides for the possibility of court-ordered sanctions for a party's 'willful failure' to comply with the duty to preserve relevant evidence."[5] The discovery-stay provisions and the concomitant duty to preserve relevant evidence "reflect a careful balance between Congress's efforts to shield defendants facing frivolous claims from the burdens of discovery, on the one hand, and its desire to ensure the preservation of evidence relevant to legally cognizable claims, on the other."[6]

Beyond Andersen's probable violation of the PSLRA's mandate to preserve relevant evidence, the auditors have almost assuredly breached a basic civil-litigation precept: "[F]undamental to the duty of production of information is the threshold duty to preserve documents and other information that may be relevant in a case."[7] In *Danis*, a case where defendants were charged with destroying crucial documents in violation of the PSLRA and the Federal Rules of Civil Procedure, the court noted that "[i]mmediately upon the filing of the ... lawsuit [defendant] was required to preserve for possible production in the lawsuit documents (whether in hard copy or electronic form) that might be discoverable. That duty flowed from both the [PSLRA] and from a common law duty not to spoil documents that might be discoverable in the litigation."[8]

Without question, Andersen had no less of a duty here from at least December 4, 2001, when it was named in Amalgamated Bank's Complaint, if not before, since the auditor disclosed on

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[4]*In re Tyco Int'l Ltd. Sec. Litig.*, No. 00-MD-1335, 2000 U.S. Dist. LEXIS 11659, at *4 (D.N.H. July 27, 2000) (citing *In re Grand Casinos Sec. Litig.*, 988 F. Supp. 1270, 1271 (D. Minn. 1997)).

[5]*Id.* at *4-*5 (citing 15 U.S.C. §78u-4(b)(3)(C)(ii)).

[6]*Id.* at *5.

[7]*Danis v. USN Communs., Inc.*, No. 98 C 7482, 2000 U.S. Dist. LEXIS 16900, at *5 (N.D. Ill. Oct. 20, 2000).

[8]*Id.* at *37.

November 30 that it had received a subpoena from the SEC, but it refused to say when.[9] And Andersen has known since last fall that its most-valuable client – $52 million in annual billings – faced financial pressures and scrutiny that could well – and did – lead to litigation.

In the wake of this collassal collapse, Andersen is accountable to the profession and to the public:

> A distinguishing mark of a profession is acceptance of its responsibility to the public.... This reliance imposes a public interest responsibility on certified public accountants. The public interest is defined as the collective well-being of the community of people and institutions the profession serves.... In discharging their professional responsibilities, members may encounter conflicting pressures from among each of those groups. In resolving those conflicts, members should act with integrity, guided by the precept that when members fulfill their responsibility to the public, clients' and employers' interests are best served.[10]

Moreover, Andersen's document destruction may well establish another significant failure: "Integrity requires a member to be, among other things, honest and candid within the constraints of client confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and the honest difference of opinion; ***it cannot accommodate deceit*** or subordination of principle."[11]

In sum, Andersen's admission – and its inability to answer the who-what-when-why-and-how about thousands of pages of destroyed documents related to the largest bankruptcy in United States history and the collapse of the country's seventh-largest company – shows that there is a significant likelihood that Enron's auditor failed its statutory and professional duty to preserve evidence. And the absence of any explanation as to why the documents were destroyed shows that the willfulness element required by the statute has been met. Consequently, pursuant to the PSLRA's §21D(b)(3)(B), Amalgamated Bank requests that the Court order Andersen to answer particularized discovery aimed at preserving and recovering evidence.

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[9]*See* D. Alexander, "SEC Subpoenas Andersen Records in Enron Collapse," *Chicago Tribune*, Dec. 1, 2001 (Ex. 4).

[10]AICPA Code of Professional Conduct §53.01-02 (Ex. 5).

[11]*Id.* at §54.02 (emphasis added).

II. DISCRETE DISCOVERY IS WARRANTED

Amalgamated Bank seeks discovery from an Andersen officer, director, partner or another person with personal knowledge on the following topics, a limited number of documents, and preservation of the auditor's electronic data. Plaintiff reserves the right to videotape the examinations and the discovery sought is without prejudice to its rights to formal discovery.

A. Deposition Topics

(1) The identity of each individual who was responsible for, directed, executed, or assisted in the destruction of any electronic and paper documents and correspondence relating to the Enron engagement.

(2) The identity of each document and category of documents Andersen believes, or has reason to believe, has or may have been destroyed.

(3) The identity of the individual(s) who discovered the evidence destruction identified in Andersen's releases, including when and how it was discovered and the auditor's response to the discovery of the destruction.

(4) All information gathered by or for Andersen concerning the reasons for the evidence destruction.

(5) All facts concerning how all Enron-related electronic and paper documents and correspondence were destroyed, including the manner in which the documents were destroyed and the location where such destruction took place.

(6) The current location of all electronic and paper documents and correspondence relating to the Enron engagement which were once destroyed but since have been recovered, reconstituted, or recreated.

(7) Andersen's past and current document-preservation policies.

(8) The steps taken by Andersen at any time to ensure that Enron-related evidence in the auditor's possession, custody or control was preserved.

(9) The facts and results of all efforts to find, identify, recreate or reconstitute any destroyed evidence.

(10) The preservation or destruction of evidence responsive to any request for production (formal or informal) or subpoena issued by the staff of the United States Securities and Exchange Commission, the United States Department of Justice or the United States Congress (including any committee or subcommittee) concerning Enron or any services Andersen performed for Enron, including auditing and accounting services.

B. Documents

(1) All documents concerning Andersen's investigation of the destruction or spoilation of Enron-related evidence.

(2) All documents concerning the success or failure of Andersen's recovery of destroyed Enron-related evidence.

C. Preservation of Electronic Evidence

Andersen has admitted that critical electronic evidence has been destroyed. Amalgamated Bank requests that the Court order the auditors to make available all relevant electronic evidence, including documents and e-mails from individual computers and Andersen computer servers, for recordation by an independent forensic computer data-recovery and preservation specialist, who will provide electronic back-ups to the Court for storage in the Court's registry. The justification is elementary and will remove any doubt as to whether what was destroyed and what is recoverable: "It is no secret that deleted files and other 'residual' data may be recovered from hard drives and floppy disks. How do you make sure you capture this data? ... [Y]ou must make what is known as an 'image copy' of the target drive ... [which] duplicates the disk surface sector by sector, thereby creating a mirror image ...."[12]

DATED: January 11, 2002

Respectfully submitted,

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[12]Joan E. Feldman & Boyer I. Kohn, *Collecting Computer-Based Evidence*, N.Y.L.J. Jan. 26, 1998 (Ex. 6). *See also In re Pac. Gateway Exchange, Inc. Sec. Litig.*, No. C 00-1211 PJH (JL), 2001 U.S. Dist. LEXIS 18433, at *6 (N.D. Cal. Oct. 17, 2001) (granting partial lifting of PSLRA discovery stay to allow plaintiffs to a mirror image "and preserve electronic data").

DECLARATION OF SERVICE BY MAIL

I, the undersigned, declare.

1. That declarant is and was, at all times herein mentioned, a citizen of the United States and a resident of the County of San Diego, over the age of 18 years, and not a party to or interest in the within action; that declarant's business address is 401 B Street, Suite 1700, San Diego, California 92101.

2. That on January 11, 2002, declarant served the AMALGAMATED BANK'S *EX PARTE* APPLICATION FOR PARTICULARIZED EXPEDITED DISCOVERY FROM DEFENDANT ARTHUR ANDERSEN LLP TO PRESERVE EVIDENCE by depositing a true copy thereof in a United States mailbox at San Diego, California in a sealed envelope with postage thereon fully prepaid and addressed to the parties listed on the attached Service List.

3. That there is a regular communication by mail between the place of mailing and the places so addressed

I declare under penalty of perjury that the foregoing is true and correct. Executed this 11th day of January, 2002, at San Diego, California.

Mo Maloney

Mo Maloney

DECLARATION OF SERVICE BY MAIL

I, the undersigned, declare

1. That declarant is and was, at all times herein mentioned, a citizen of the United States and a resident of the County of San Diego, over the age of 18 years, and not a party to or interest in the within action; that declarant's business address is 401 B Street, Suite 1700, San Diego, California 92101

2 That on January 11, 2002, declarant served the ORDER IN SUPPORT OF AMALGAMATED BANK'S *EX PARTE* APPLICATION FOR PARTICULARIZED EXPEDITED DISCOVERY FROM DEFENDANT ARTHUR ANDERSEN LLP TO PRESERVE EVIDENCE by depositing a true copy thereof in a United States mailbox at San Diego, California in a sealed envelope with postage thereon fully prepaid and addressed to the parties listed on the attached Service List.

3. That there is a regular communication by mail between the place of mailing and the places so addressed.

I declare under penalty of perjury that the foregoing is true and correct Executed this 11th day of January, 2002, at San Diego, California

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Andersen notifies SEC, Justice Department, Congress that a significant but undetermined number of Enron-related documents were disposed of; firm issues new interim document management policy; asks former U.S. Sen. Danforth to review records management policies

CHICAGO, January 10, 2002 — Andersen has notified the U.S. Securities and Exchange Commission and the U.S. Department of Justice, and is also notifying congressional committees and other agencies investigating the Enron collapse, that in recent months individuals in the firm involved with the Enron engagement disposed of a significant but undetermined number of electronic and paper documents and correspondence relating to the Enron engagement.

In addition to notifying authorities, Andersen has suspended its current records management policy effective immediately and instructed all partners and personnel to retain all existing documents until further notice. The firm also has asked former U.S. Sen. John Danforth to conduct an immediate and comprehensive review of Andersen's records management policy and to recommend improvements.

The firm has assured the SEC, the Justice Department, congressional committees and other agencies that it will continue to cooperate fully with their investigations. After government agencies have had a full opportunity to consider these matters; Danforth also will advise the firm to ensure that all appropriate remedial and disciplinary actions have been taken.

Andersen's suspended document policy required in certain circumstances the destruction of certain types of documents. In recent months, documents, including electronic files related to the Enron engagement, were disposed of or deleted. Millions of documents related to Enron still exist, and the firm has successfully retrieved some of the deleted electronic files. The firm is continuing retrieval efforts through electronic backup files, and is continuing in its efforts to fully learn and understand all the facts related to this issue.

Danforth served in the U.S. Senate from 1976 to 1995. He headed the Committee on Commerce, Science and Transportation. He is the former Attorney General of Missouri, an ordained minister in the Episcopal Church, and currently serves as a partner with the law firm of Bryan Cave LLP.

About Andersen
Andersen is a global leader in professional services. It provides integrated solutions that draw on diverse and deep competencies in consulting, assurance, tax, corporate finance, and in some countries, legal services. Andersen employs 85,000 people in 84 countries. Andersen is frequently rated among the best places to work by leading publications around the world. It is also consistently ranked first in client satisfaction in independent surveys. Andersen has enjoyed uninterrupted growth since its founding in 1913. Its 2001 revenues totaled US$9.3 billion. Andersen refers to the brand identity adopted by member firms of the Andersen global client service network.

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Additional Andersen statement on Enron-related documents

CHICAGO, January 10, 2002 — Certain questions have been asked regarding the statement Andersen issued earlier today. The following is to respond to these questions and clarify certain issues:

What does the firm mean when it says documents were disposed of "in recent months?"

Discarding of documents occurred during the months before the SEC issued a subpoena to Andersen. After receiving the SEC subpoena, the firm issued an instruction to preserve documents. At this time, we have not been able to determine whether that instruction was violated.

Has the firm taken any disciplinary actions?

The firm is working to gather the facts and determine appropriate disciplinary actions.

When you refer to "individuals in the firm" are you referring to Andersen personnel?

Yes. The reference is to individuals in Andersen.

Audit Nightmare: Arthur Andersen Says It Disposed of Documents That Related to Enron --- 'When' Is a Key Question For Accountants in Wake Of the Client's Collapse --- Ex-Senator Hired for Review
By Wall Street Journal staff reporters Jonathan Weil, John Emshwiller and Scot J. Paltrow

01/11/2002
The Wall Street Journal
A1

The storm cloud hanging over **Enron** Corp. and its longtime outside auditor, Arthur Andersen LLP, just got darker.

In the latest revelation in the collapse of **Enron**, Arthur Andersen disclosed to federal agencies investigating the energy trading firm that individuals at the accounting firm in recent months disposed of "a significant but undetermined number" of documents related to its work for **Enron**.

The terse announcement left many questions unanswered. Who disposed of the documents and how? Why? Did it happen after investigations began?

In any event, the disclosure appeared likely to further damage the already-tarnished reputation of the nation's fifth-largest accounting firm. The Securities and Exchange Commission, which is investigating **Enron**, said destruction of documents is "an extremely serious matter."

Andersen officials were called late last year to testify to a congressional committee about why the firm failed to detect the financial woes that contributed to **Enron**'s downfall. The Justice Department said this week that it had formed a task force to pursue a criminal investigation of **Enron**. A department spokesman wouldn't say whether the agency knew of document destruction or whether Andersen was a target of criminal investigation.

Andersen's disclosure will increase pressure on the firm to fully disclose its handling of the **Enron** account. Dec. 12 congressional testimony by Joseph F. Berardino, Andersen's managing partner and chief executive officer, may have mischaracterized part of one **Enron** deal and understated Andersen's knowledge about it, people familiar with the matter say. Andersen says the testimony was truthful but based on incomplete information.

White House spokesman Ari Fleischer said yesterday he had no knowledge that the Bush administration got advance word from Andersen of the document destruction. But President Bush called for a government review of the **Enron** case, amid disclosure that **Enron** chief Kenneth Lay lobbied two cabinet secretaries for help as the company was nearing bankruptcy court. Mr. Lay also contacted Federal Reserve Chairman Alan Greenspan around the same time, a Fed spokesman confirmed.

Yesterday, Attorney General John Ashcroft said he had recused himself from the Justice Department's investigation of **Enron**, citing a conflict of interest. In addition, the Justice Department said much of the U.S. attorney's office in Houston would be recused because of family ties.

In Houston, an **Enron** spokeswoman declined to comment on Andersen's document disposal, other than to say that the accounting firm's announcement was the first **Enron** had heard about it. The spokeswoman added, "We are not aware of the shredding of any documents that are part of any inquiry, investigation or litigation matter."

For Andersen, the **Enron** mess could hardly come at a worse time. In recent years, the firm has approved the financial statements of a series of its high-profile corporate clients, including Sunbeam Corp. and Waste Management Inc., that later proved to be false. Andersen paid tens of millions of dollars in damages to each company's shareholders, without admitting wrongdoing in either case. The deepening investigation into **Enron** could make it harder for Andersen to attract new clients and seems sure to distract top executives for a time.

Andersen said it asked former Sen. John Danforth, a Missouri Republican, "to conduct an immediate and comprehensive review of Andersen's records management policy" and to "advise the firm to ensure that all appropriate remedial and disciplinary actions have been taken."

While Andersen has defended its audits of **Enron**, critics say the firm failed to identify a number of questionable accounting practices by **Enron** that contributed to its abrupt downfall. Once the dominant player in energy trading, the Houston company had to file for bankruptcy-court protection after a series of disclosures.

Enron had transactions with certain partnerships that were run by its own officers -- including its chief financial officer at the time, Andrew Fastow -- but that were treated by **Enron** as separate. It offered only murky and fragmented information about the partnerships. One of them, whose existence **Enron** didn't disclose for four years, was part of an arrangement that inflated earnings by several hundred million dollars.

And **Enron**'s debt level was much higher than it revealed, thanks to the partnerships, which allowed **Enron** to keep some debt off its books. In November, a restatement by **Enron** of its financial results -- which Andersen had approved as accurate -- resulted in lowering **Enron**'s reported earnings for the prior four years by $586 million, or 20%. **Enron** said its previous financial statements for those years could no longer be relied upon.

Among issues investigators now will doubtless probe is how many and which **Enron**-related documents were destroyed, and who destroyed them. Andersen said "individuals" had disposed of "a significant but undetermined number of electronic and paper documents and correspondence." It added, "Millions of documents related to **Enron** still exist, and the firm has successfully retrieved some of the deleted electronic files. The firm is continuing retrieval efforts through electronic backup files, and is continuing in its efforts to fully learn and understand all the facts related to this issue."

Another issue will be when the documents were destroyed. The firm said it had a policy -- now suspended -- that "required in certain circumstances the destruction of certain types of documents." Many big corporations have similar policies specifying how long employees must retain certain categories of records.

Under prevailing regulations, auditors are required to "adopt reasonable procedures for safe custody" of their working papers and should keep them for long enough "to satisfy any pertinent legal requirements of records retention." People with knowledge of the Justice Department's **Enron** probe said Andersen didn't destroy any audit working papers.

The destruction of documents would be especially troubling to investigators and regulators if some of it occurred after they had begun their inquiries into **Enron**'s downfall. That would raise the question of whether the action was designed to thwart investigators. Andersen said it had confirmed that certain **Enron**-related documents were destroyed "during the months before" the SEC issued a subpoena to Andersen. It said it hadn't determined whether any were destroyed after the subpoena, but said it had told personnel after the subpoena arrived to preserve **Enron**-related documents.

Andersen's revelation about document disposal could raise embarrassing questions for Deloitte & Touche LLP, which this month released results of a "peer review" of Andersen's system of accounting and auditing quality. The review -- which focused on the firm's practices generally and not on its handling of **Enron** -- concluded that Andersen's system of accounting and auditing quality provided "reasonable assurance of compliance with professional standards."

A Deloitte official said that the firm's peer review of Andersen included an evaluation of the firm's Houston office, which handled **Enron**'s audits, but that Deloitte wasn't permitted to include Andersen's audit work for **Enron** because of pending litigation. Neither Deloitte nor Andersen would comment on whether the review would be reopened.

The unfolding **Enron** saga could have a detrimental effect overall on Andersen, which employs 85,000 people in 84 countries and last year had U.S. revenue of $9.3 billion. As with all accounting firms, Andersen's ability to attract and retain audit clients depends on having a sterling reputation. The more its reputation comes into question, the more likely it becomes that investors will view an audit opinion by Andersen with skepticism, prompting some clients to switch to other auditors.

There is no evidence that has happened so far. Asked whether Andersen has been told by any clients that they are switching to other auditors, spokesman David Tabolt said, "Some have been concerned. Some have been supportive. I just don't think that we know yet how people are going to react, but we certainly hope that people will be understanding." More than a dozen companies that use Andersen as their auditor declined to comment on whether they might review their relationship.

Andersen also has taken heat over its audit of the Baptist Foundation of Arizona. Arizona state authorities are seeking as much as $600 million in restitution from the firm. They are also seeking to place Andersen on probation in the state, which could include restrictions and heightened monitoring.

Two of the Andersen auditors involved have invoked their Fifth Amendment protections against self-incrimination in civil suits brought in that case. They include one who also was Andersen's lead engagement partner for Lincoln Savings & Loan, the failed thrift once headed by Charles Keating.

Andersen has said it is cooperating with Arizona officials investigating its audits for the foundation, which filed for bankruptcy protection two years ago, shortly after Andersen left the account in mid-1999.

Michael Schroeder and Rebecca Smith contributed to this article.

Business/Financial Desk; Section C
ENRON'S COLLAPSE: THE AUDITOR
Enron's Auditor Says It Destroyed Documents
By KURT EICHENWALD and FLOYD NORRIS

01/11/2002
The New York Times
Page 1, Column 3

As the fortunes of the **Enron** Corporation unraveled in late 2001, officials of its accounting firm, **Arthur Andersen** & Company, destroyed "a significant but undetermined number" of **documents** relating to the company and its finances, Andersen disclosed yesterday.

The document destruction began in September, a government investigator said, and continued into November, after **Enron** announced that the Securities and Exchange Commission was conducting a formal investigation of **Enron**'s finances.

In November, the S.E.C. subpoenaed Andersen for records related to **Enron**, and the accounting firm told its employees that such **documents** should be preserved. But Andersen said **documents** may have been destroyed even after that.

"At this time, we cannot say whether that instruction was violated," said David W. Tabolt, a spokesman for Andersen.

The **documents** -- including correspondence and both electronic and paper records -- were destroyed by employees involved with the **Enron** assignment, Andersen said. The 89-year-old firm, the smallest of accounting's Big Five, said it had notified the S.E.C., the Justice Department and members of Congress investigating the **Enron** case of the records' disposal.

The S.E.C. said that it would expand its investigation of **Enron**'s collapse to include Andersen's newly disclosed conduct.

"Destruction of **documents** is obviously an extremely serious matter," said Steven Cutler, the director of enforcement for the S.E.C. "The destruction of **documents** by **Arthur Andersen** will not deter us from pursuit of our investigation and will be included within the scope of our investigation."

Representative Billy Tauzin, Republican of Louisiana and chairman of the House Energy and Commerce Committee, which has been investigating **Enron**'s collapse, said that the destruction could merit criminal charges if it was done to obstruct inquiries into the matter.

"Anyone who destroyed records simply out of stupidity should be fired," Mr. Tauzin said. "Anyone who destroyed records intentionally to subvert our investigation should be prosecuted."

Concerns about Andersen's handling of **Enron documents** have been growing for several days, according to a Congressional staff member. In December, the Energy and Commerce Committee subpoenaed Andersen for certain records, but did not receive all the materials it expected. On Wednesday, investigators for the committee went to Andersen's Houston office in search of the missing records; many of those turn out to have been among the **documents** that were destroyed.

Committee staff members are planning to interview Andersen officials in Houston next week, in part to determine what led to the document destruction, according to Ken Johnson, an aide to Mr. Tauzin.

Officials of the Justice Department, which has formed a special task force to investigate the **Enron** debacle, declined to comment on Andersen's disclosure.

Mr. Tabolt of Andersen said that the firm was still gathering information about the episode before deciding what if any discipline to administer to the employees involved.

The electronic records that were destroyed appear to have numbered in the thousands, according to a government official who has been briefed on the matter. Some of those records have been recovered, Andersen said. There has been no accounting yet of the volume of paper **documents** that were destroyed.

Andersen gave no explanation for the records' destruction, but announced yesterday that it was suspending its records management policy, which allowed for periodic disposal of records after certain periods of time. It did not say, however, whether the destruction of the **Enron documents** had been in compliance with its policy.

The firm also said that it had asked former Senator John Danforth, now a partner with the law firm of Bryan Cave, to review its policy for managing records and recommend improvements. An employee at Bryan Cave said that Mr. Danforth was out of the country and unavailable.

James M. Cole, a partner at the firm's Washington office, will join Mr. Danforth in the review, according to Daniel Schwartz, head of the firm's corporate compliance client service group. Mr. Cole is the former deputy chief of the public integrity section of the Justice Department and served as a special counsel to the House Ethics Committee in its investigation of Newt Gingrich.

Mr. Schwartz said that his firm had been approached by Andersen over the last few days and asked to review its document management system. Mr. Schwartz said he did not know if Andersen meant to imply that the destruction of **Enron documents** was a result of that system.

On Oct. 16, **Enron** announced a $618 million third-quarter loss, and questions began to arise about certain limited partnerships related to the company that were used to purchase **Enron** assets. Within a day, the company was facing a shareholder lawsuit, and shortly thereafter, **Enron** received an informal request for information from the S.E.C.'s Fort Worth office. The case was then moved to Washington, and the S.E.C. issued a formal order of investigation at the end of October.

Andersen has audited **Enron** since the company was formed by a merger in the 1980's, and many former Andersen auditors have gone on to work for **Enron.** They include Richard A. Causey, **Enron**'s chief accounting officer, and Jeffrey McMahon, who became the company's chief financial officer in October after his predecessor was forced out.

On Nov. 8, **Enron** restated five years of earnings, saying it improperly booked half a billion dollars of profits. Joseph F. Berardino, Andersen's chief executive, testified before Congress last month that **Enron** engaged in "possibly illegal acts" by withholding information from its auditors related to its earnings. Mr. Berardino also conceded that errors by Andersen had contributed to erroneous financial reporting by **Enron.**

There were no investigations of **Enron** going on in September, when, Mr. Johnson said, the destruction of **documents** began, although the share price had fallen sharply from its peak of $90.75 reached in 2000. The shares rallied in early October and were at $33.84 on Oct. 16.

But a disclosure made by Kenneth L. Lay, **Enron**'s chairman and chief executive, about a $1.2 billion reduction of shareholder equity began to bother investors within days. That reduction related to **Enron**'s transactions with partnerships run by Andrew **Fastow**, then the company's chief financial officer. As investors clamored for more information about those transactions, Mr. Lay first defended Mr. Fastow and then announced he was being replaced.

Andersen has declined to say just what role it played in setting up either the Fastow partnerships or other off-balance-sheet **Enron** transactions that appear to have been used to make **Enron**'s financial statements seem better than they were. But it did approve the accounting for all those partnerships.

Andersen has also encountered problems in the last year over two other highly publicized audits: The S.E.C. filed a civil fraud complaint against an Andersen partner who certified statements at Sunbeam, the bankrupt appliance maker, showing what turned out to be inflated profits, and the firm was named by the S.E.C. in the Waste Management case, which led to the first fraud settlement by a major accounting firm in decades.

Photos: **Enron** grew from a pipeline company based in Houston into the world's largest energy trader. The share price reached $90.75 in 2000, but the company collapsed late last year.; Joseph F. Berardino, **Arthur Andersen**'s chief executive, testified before Congress last month that **Enron** engaged in "possibly illegal acts" by withholding information from its auditors. He also said errors by Andersen had contributed to erroneous reporting by **Enron.** (Carol T. Powers)

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HEADLINE: SEC subpoenas Andersen records in Enron collapse;
Auditing quality defended by CEO

BYLINE: By Delroy Alexander, Tribune staff reporter.

BODY:
The search for answers to how Enron Corp. could have fallen from grace so fast has turned to the energy giant's advisers, its Chicago-based auditor confirmed Friday.

The Securities and Exchange Commission has issued a subpoena calling for Andersen, formerly known as Arthur Andersen, to hand over documents relating to its Enron audits. "We did receive a subpoena in relation to our financial reporting on Enron, which is a customary part of the process," said Dave Tabolt, a spokesman for the Big Five accounting practice. He would not say when the subpoenas were issued.

The SEC declined to comment on its probe, but it is standard practice for the regulator to issue subpoenas because client confidentiality arrangements prohibit the release of information by professional services firms, say attorneys familiar with the process.

In a belated bid to shore up public confidence in its financial reporting skills, Andersen said Friday it had asked for outside help to review its auditing methodology and tools to see if procedural changes are needed.

Rival Big Five accounting firm Deloitte & Touche already is carrying out a peer review of Andersen, a yearly self-regulatory process in which accounting firms examine one another and publish opinions that assure investors that audits performed by the firms comply with accounting standards.

Andersen said the process would be expanded to include review procedures in its Houston office, which handled the Enron auditing.

"We are confident that our system of quality is strong," said Joseph F. Berardino, managing partner and chief executive.

Still, U.S. Rep. John Dingell of Michigan, ranking Democrat on the House Energy and Commerce Committee, has questioned the veracity of the peer-review process and Andersen's failure to see through Enron's "smoke-and-mirrors earnings."

Houston-based Enron's share price began plummeting in mid-October, after it revealed that it had overstated earnings for several years and used questionable partnerships to conceal the existence of billions of dollars in debt. Its shares closed Friday at 26 cents, down 10 cents on the New York Stock Exchange. A year ago, Enron shares stood at $85.

With Enron's troubles, Andersen, which audits some 1,400 public companies and thousands more private firms, again finds itself in the spotlight.

In June, Andersen reached a $7 million settlement with the SEC in which it neither admitted nor denied allegations of fraud in its audit of Houston-based Waste Management Inc.

Public concern over the veracity of audits has been increasing in recent years, and the SEC has made financial reporting a priority. In the fiscal year ended Sept. 30, the SEC filed 112 financial reporting cases, up from 103 in 2000 and 94 in 1999.

But the SEC probe is the "least of Andersen's problems," according to Mark Cheffers, a former Pricewaterhouse auditor who runs AccountingMalpractice.com, a liability training Web site that caters to an estimated 20,000 accountants.

Cheffers thinks shareholder suits are far more worrisome. Andersen this year agreed to pay $110 million to settle class-action litigation brought on behalf of shareholders of another client, Sunbeam Corp., which had misstated its financial results during the 1990s. Andersen did not admit fault or liability in the settlement.

The settlement was the second largest paid by an accounting firm in a securities lawsuit. The record is $335 million paid by Ernst & Young to Cendant Corp. shareholders in 1999.

GRAPHIC: PHOTOPHOTO: People pass by the Houston offices of Enron, whose woes have led to questions about its audit. AP photo.

LOAD-DATE: December 1, 2001

AU Section 339

Working Papers

(Supersedes Statement on Auditing Standards No. 1, section 338, "Working Papers.")[1]

Source: SAS No. 41.

See section 9339 for interpretations of this section.

Issue date, unless otherwise indicated: April 1, 1982.

.01 The auditor should prepare and maintain working papers, the form and content of which should be designed to meet the circumstances of a particular engagement.[2] The information contained in working papers constitutes the principal record of the work that the auditor has done and the conclusions that he has reached concerning significant matters.[3]

Functions and Nature of Working Papers

.02 Working papers serve mainly to—

a. Provide the principal support for the auditor's report, including his representation regarding observance of the standards of field work,

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[1] This section amends section 230, *Due Professional Care in the Performance of Work*, paragraph .04, by deleting the second sentence of that paragraph.

[2] This section does not modify the guidance in other Statements on Auditing Standards, including the following:

- The letter of audit inquiry to the client's lawyer required by section 337, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*, paragraphs .08–.09, or the documentation required by paragraph .10 when a response to the audit inquiry letter is received in a conference
- The written representations from management required by section 333, *Management Representations*
- The notation in the working papers required by section 325, *Communication of Internal Control Related Matters Noted in an Audit*, paragraph .09, if conditions relating to internal control observed during an audit of financial statements are communicated orally to the audit committee or others with equivalent authority and responsibility
- The written audit program or set of written audit programs required by section 311, *Planning and Supervision*, paragraph .05
- The representation letter from a successor auditor required by section 711, *Filings Under Federal Securities Statutes*, paragraph .11b, when an auditor has audited the financial statements for prior periods but has not audited the financial statements for the most recent audited period included in a registration statement
- The understanding of internal control components obtained to plan the audit, and the basis for conclusions about the assessed level of control risk required by section 319.44 and 319.57 *Consideration of Internal Control in a Financial Statement Audit*
- The notation in the working papers required by section 317, *Illegal Acts by Clients*, if illegal acts are communicated orally to the audit committee or others with equivalent authority and responsibility
- The notation in the working papers required by section 380, *Communication With Audit Committees* (if applicable), paragraph .03, if matters regarding the scope and results of the audit are communicated orally to the committee
- The notation in the working papers required by section 316, *Consideration of Fraud in a Financial Statement Audit*, paragraph .37, of the performance of the assessment of the risk of material misstatement due to fraud and the auditor's response to the risk factors identified.

[3] However, there is no intention to imply that the auditor would be precluded from supporting his report by other means in addition to working papers.

which is implicit in the reference in his report to generally accepted auditing standards.

b. Aid the auditor in the conduct and supervision of the audit.

.03 Working papers are records kept by the auditor of the procedures applied, the tests performed, the information obtained, and the pertinent conclusions reached in the engagement. Examples of working papers are audit programs, analyses, memoranda, letters of confirmation and representation, abstracts of company documents, and schedules or commentaries prepared or obtained by the auditor. Working papers also may be in the form of data stored on tapes, films, or other media.

.04 Factors affecting the auditor's judgment about the quantity, type, and content of the working papers for a particular engagement include (*a*) the nature of the engagement, (*b*) the nature of the auditor's report, (*c*) the nature of the financial statements, schedules, or other information on which the auditor is reporting, (*d*) the nature and condition of the client's records, (*e*) the assessed level of control risk, and (*f*) the needs in the particular circumstances for supervision and review of the work.

Content of Working Papers

.05 The quantity, type, and content of working papers vary with the circumstances (see paragraph .04), but they should be sufficient to show that the accounting records agree or reconcile with the financial statements or other information reported on and that the applicable standards of field work have been observed. Working papers ordinarily should include documentation showing that—

a. The work has been adequately planned and supervised, indicating observance of the first standard of field work.

b. A sufficient understanding of internal control has been obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed.

c. The audit evidence obtained, the auditing procedures applied, and the testing performed have provided sufficient competent evidential matter to afford a reasonable basis for an opinion, indicating observance of the third standard of field work.

Ownership and Custody of Working Papers

.06 Working papers are the property of the auditor, and some states have statutes that designate the auditor as the owner of the working papers. The auditor's rights of ownership, however, are subject to ethical limitations relating to the confidential relationship with clients.

.07 Certain of the auditor's working papers may sometimes serve as a useful reference source for his client, but the working papers should not be regarded as a part of, or a substitute for, the client's accounting records.

.08 The auditor should adopt reasonable procedures for safe custody of his working papers and should retain them for a period sufficient to meet the needs of his practice and to satisfy any pertinent legal requirements of records retention.

Effective Date

.09 This section is effective for engagements beginning after May 31, 1982.

AU Section 9339

Working Papers: Auditing Interpretations of Section 339

1. Providing Access to or Photocopies of Working Papers to a Regulator[1, 2]

.01 *Question*—Section 339, *Working Papers*, paragraph .06, states that "working papers are the property of the auditor and some states have statutes that designate the auditor as the owner of the working papers. The auditor's rights of ownership, however, are subject to ethical limitations relating to the confidential relationship with clients." In addition, section 339.08 states that, "The auditor should adopt reasonable procedures for safe custody of his working papers and should retain them for a period sufficient to meet the needs of his practice and to satisfy any pertinent legal requirements of records retention."

Notwithstanding the provisions of section 339.06 and .08, auditors are sometimes required by law, regulation or audit contract,[3] to provide a regulator, or a duly appointed representative, access to working papers. For example, a regulator may request access to the working papers to fulfill a quality review requirement or to assist in establishing the scope of a regulatory examination. Furthermore, as part of the regulator's review of the working papers, the regulator may request photocopies of all or selected portions of the working papers during or after the review. The regulator may intend, or decide, to make photocopies (or information derived from the original working papers) available to others, including other governmental agencies, for their particular purposes, with or without the knowledge of the auditor or the client. When a regulator requests the auditor to provide access to (and possibly photocopies of) working papers pursuant to law, regulation or audit contract, what steps should the auditor take?

.02 *Interpretation*—When a regulator requests access to working papers pursuant to law, regulation or audit contract, the auditor should take the following steps:

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[1] The term "regulator(s)" includes federal, state and local government officials with legal oversight authority over the entity. Examples of regulators who may request access to working papers include, but are not limited to, state insurance and utility regulators, various health care authorities, and federal agencies such as the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the Department of Housing and Urban Development, the Department of Labor, and the Rural Electrification Administration.

[2] The guidance in this Interpretation does not apply to requests from the Internal Revenue Service, firm practice-monitoring programs to comply with AICPA or state professional requirements such as peer or quality reviews, proceedings relating to alleged ethics violations, or subpoenas.

[3] For situations in which the auditor is not required by law, regulation or audit contract to provide a regulator access to the working papers, reference should be made to the guidance in paragraphs .11–.15 of this Interpretation.

e. States that the audit and the working papers should not [illegible] other inquiries and procedures that should be undertaken by the regulator for its purposes

f. Requests confidential treatment under the Freedom of Information Act or similar laws and regulations,[5] when a request for the working papers is made, and that written notice be given to the auditor before transmitting any information contained in the working papers to others, including other governmental agencies, except when such transfer is required by law or regulation, and

g. States that if any photocopies are to be provided, they will be identified as "Confidential Treatment Requested by (*name of auditor, address, telephone number*)."

The auditor may wish to obtain a signed acknowledgment copy of the letter as evidence of the regulator's receipt of the letter.

.06 An example of a letter containing the elements described in paragraph .05 of this Interpretation is presented below:

Illustrative Letter to Regulator[6]

(*Date*)

(*Name and Address of Regulatory Agency*)

Your representatives have requested access to our working papers in connection with our audit of the December 31, 20XX financial statements of (*name of client*). It is our understanding that the purpose of your request is (*state purpose: for example, "to facilitate your regulatory examination."*).[7]

Our audit of (*name of client*) December 31, 20XX financial statements was conducted in accordance with auditing standards generally accepted in the United States of America,[8] the objective[9] of which is to form an opinion as to whether the financial statements, which are the responsibility and representations of management, present fairly, in all material respects, the financial position, results of operations and cash flows in conformity with generally accepted accounting principles.[10] Under generally accepted auditing standards,

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[5] The auditor may need to consult the regulations of individual agencies and, if necessary, consult with legal counsel regarding the specific procedures and requirements necessary to gain confidential treatment.

[6] The auditor should appropriately modify this letter when the audit has been performed in accordance with generally accepted auditing standards and also in accordance with additional auditing requirements specified by a regulatory agency (for example, the requirements specified in *Government Auditing Standards* issued by the Comptroller General of the United States).

[7] If the auditor is not required by law, regulation, or audit contract to provide a regulator access to the working papers but otherwise intends to provide such access (see paragraphs .11–.15 of this Interpretation), the letter should include a statement that: "Management of (*name of client*) has authorized us to provide you access to our working papers for (*state purpose*)."

[8] Refer to footnote 6.

[9] In an audit performed in accordance with the *Single Audit Act of 1984*, and certain other federal audit requirements, an additional objective of the audit is to assess compliance with laws and regulations applicable to federal financial assistance. Accordingly, in these situations, the above letter should be modified to include the additional objective.

[10] If the financial statements have been prepared in conformity with regulatory accounting practices, the phrase "financial position, results of operations and cash flows in conformity with generally accepted accounting principles" should be replaced with appropriate wording such as, in the case of an insurance company, the "admitted assets, liabilities... of the XYZ Insurance Company in conformity with accounting practices prescribed or permitted by the state of... insurance department."

a. Consider advising the client that the regulator has requested access to (and possibly photocopies of) the working papers and that the auditor intends to comply with such request.[4]

b. Make appropriate arrangements with the regulator for the review.

c. Maintain control over the original working papers, and

d. Consider submitting the letter described in paragraph .05 of this Interpretation to the regulator.

.03 The auditor should make appropriate arrangements with the regulator. These arrangements ordinarily would include the specific details such as the date, time and location of the review. The working papers may be made available to a regulator at the offices of the client, the auditor, or a mutually agreed-upon location, so long as the auditor maintains control. Furthermore, the auditor should take appropriate steps to maintain custody of the original working papers. For example, the auditor (or his or her representative) should consider being present when the original working papers are reviewed by the regulator. Maintaining control of the working papers is necessary to ensure the continued integrity of the working papers and to ensure confidentiality of client information.

.04 Ordinarily, the auditor should not agree to transfer ownership of the working papers to a regulator. Furthermore, the auditor should not agree, without client authorization, that the information contained therein about the client may be communicated to or made available to any other party. In this regard, the action of an auditor providing access to, or photocopies of, the working papers shall not constitute transfer of ownership or authorization to make them available to any other party.

.05 An audit performed in accordance with generally accepted auditing standards is not intended to, and does not, satisfy a regulator's oversight responsibilities. To avoid any misunderstanding, prior to allowing a regulator access to the working papers, the auditor should consider submitting a letter to the regulator that:

a. Sets forth the auditor's understanding of the purpose for which access is being requested

b. Describes the audit process and the limitations inherent in a financial statement audit

c. Explains the purpose for which the working papers were prepared, and that any individual conclusions must be read in the context of the auditor's report on the financial statements

d. States, except when not applicable, that the audit was not planned or conducted in contemplation of the purpose for which access is being granted or to assess the entity's compliance with laws and regulations

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[4] The auditor may wish (and in some cases may be required by law, regulation, or audit contract) to confirm in writing with the client that the auditor may be required to provide a regulator access to the working papers. Sample language that may be used follows:

"The working papers for this engagement are the property of (*name of auditor*) and constitute confidential information. However, we may be requested to make certain working papers available to (*name of regulator*) pursuant to authority given to it by law or regulation. If requested, access to such working papers will be provided under the supervision of (*name of auditor*) personnel. Furthermore, upon request, we may provide photocopies of selected working papers to (*name of regulator*). The (*name of regulator*) may intend, or decide, to distribute the photocopies or information contained therein to others, including other governmental agencies."

Section 53 - Article II: The Public Interest

Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism.

.01 A distinguishing mark of a profession is acceptance of its responsibility to the public. The accounting profession's public consists of clients, credit grantors, governments, employers, investors, the business and financial community, and others who rely on the objectivity and integrity of certified public accountants to maintain the orderly functioning of commerce. This reliance imposes a public interest responsibility on certified public accountants. The public interest is defined as the collective well-being of the community of people and institutions the profession serves.

.02 In discharging their professional responsibilities, members may encounter conflicting pressures from among each of those groups. In resolving those conflicts, members should act with integrity, guided by the precept that when members fulfill their responsibility to the public, clients' and employers' interests are best served.

.03 Those who rely on certified public accountants expect them to discharge their responsibilities with integrity, objectivity, due professional care, and a genuine interest in serving the public. They are expected to provide quality services, enter into fee arrangements, and offer a range of services—all in a manner that demonstrates a level of professionalism consistent with these Principles of the Code of Professional Conduct.

.04 All who accept membership in the American Institute of Certified Public Accountants commit themselves to honor the public trust. In return for the faith that the public reposes in them, members should seek continually to demonstrate their dedication to professional excellence.

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Section 54 - Article III: Integrity

To maintain and broaden public confidence, members should perform all professional responsibilities with the highest sense of integrity.

.01 Integrity is an element of character fundamental to professional recognition. It is the quality from which the public trust derives and the benchmark against which a member must ultimately test all decisions.

.02 Integrity requires a member to be, among other things, honest and candid within the constraints of client confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and the honest difference of opinion; it cannot accommodate deceit or subordination of principle.

.03 Integrity is measured in terms of what is right and just. In the absence of specific rules, standards, or guidance, or in the face of conflicting opinions, a member should test decisions and deeds by asking: "Am I doing what a person of integrity would do? Have I retained my integrity?" Integrity requires a member to observe both the form and the spirit of technical and ethical standards; circumvention of those standards constitutes subordination of judgment.

.04 Integrity also requires a member to observe the principles of objectivity and independence and of due care.

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TECH TRENDS: Legal Tech 1998 Special Section

Collecting Computer-Based Evidence

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BY JOAN E. FELDMAN AND RODGER I. KOHN

TODAY IT IS BLACK letter law that information generated and stored on computers and in other electronic forms is discoverable.(1) It is estimated that as much as 30 percent of the data stored on computers is never reduced to printed form. Moreover, the electronic version of a document may contain information that simply does not appear in the printed version. As a practical matter, finding this information is becoming an important part of the discovery process.

Many lawyers now ask for electronic evidence, especially E-mail, as a routine part of their discovery efforts. But as a practical matter, most lawyers have little or no experience in collecting and analyzing the data they seek. What follows is some practical advice on how to collect the relevant data, and how to assure that it can be authenticated and admitted as evidence.

1. Send a preservation of evidence letter. Because the information stored on computers changes every time a user saves a file, loads a new program or does almost anything else on his or her PC, it is critical that you put all parties on notice that you will be seeking electronic evidence through discovery. The sooner the notice is sent the better. A letter should identify as specifically as possible the types of information to be preserved and note the possible places that information may exist.(2) If necessary, obtain a protective order requiring all parties to preserve electronic evidence and setting out specific protocols for doing so.

2. Include definitions, instructions and specific

questions about electronic evidence in your written discovery. This is a continuing process, with three objectives to accomplish:

- First, use a series of interrogatories to get an overview of the target computer system. These will be followed up by a 30(b)(6) deposition of the information systems department.

- Second, all requests for production should make clear that electronic documents as well as paper are being sought. You can accomplish this by defining documents to include items such as data compilations, E-mail and electronically stored data. Requests should also ask specifically for different types of computer-based evidence, such as diskettes, E-mail and backup tapes.

- Finally, if necessary, include a request for inspection so you can examine the computer system firsthand and retrieve any relevant data.

3. Take a 30(b)(6) deposition of the information systems department. This is the single best tool for finding out the types of electronic information that exist in your opponent's computer systems.

4. Collect backup tapes. One of the most fertile sources of evidence is the routine backup created to protect data in case of disaster. This information is normally stored on high-capacity tapes, but may exist on virtually any type of media. Backup tapes normally contain all of an organization's data, including E-mail, as of a certain date. Common procedures call for full backups to be made weekly, with the last tape of the month saved as a monthly backup. While weekly backups are normally rotated, monthly backups are saved anywhere from six months to several years.

When collecting backup tapes in discovery, make sure to gather information on how the tapes were made. This inquiry must include both the procedures followed and the specific hardware and software used to make the backups. Over time, hundreds of different backup methods have been used; in some cases, it may be impossible to restore backups without using the same software and/or hardware that was used to create them.

5. Collect diskettes. Data that has been selectively saved by users to diskettes or other portable media is another fertile, but often overlooked, source of evidence. Users save data to diskettes for any number of reasons. They create "ad hoc backups" of key documents or files; they copy E-mail files to prevent them from being deleted in automatic purging routines. Finally, users will use diskettes to save data they do not want to keep on company computers.

Diskettes are kept indefinitely by the users who create them. Collecting and examining all diskettes created by key witnesses is an essential step in a thorough examination of all electronic evidence.

6. Ask every witness about computer usage. In addition to the discovery directed at the computer system, each witness must be questioned about his or her computer use. Individual users' sophistication varies widely; knowing how each witness uses his or her computer and organizes and stores data may lead to sources of information not revealed by the discovery directed at general system usage. This discovery should also focus on the secretaries and other people assisting key witnesses. Often, documents drafted by the key witness are stored on an assistant's computer.

Perhaps the most overlooked source of electronic evidence is the home computer. Data usually ends up on these machines in one of two ways: First, it can be transferred to and from the workplace on diskettes or other portable media; second, an employee may be able to log on to the company network from home. In this latter situation, the home computer acts just like the employee's office workstation.

Palmtop devices and notebook computers are also good sources of evidence. Palmtop devices include electronic address books as well as more powerful devices such as 3Com's PalmPilot and Apple's Newton. In addition to storing calendar and contact information, many of these devices allow users to make notes and use E-mail. Further up the scale, there are notebook computers, which are often shared among a number of users. While a notebook may not be a witness's primary workstation, it still may contain important pieces of information.

7. Make image copies. It is no secret that deleted files and other ``residual'' data may be recovered from hard drives and floppy disks. How do you make sure that you capture this data? Answering this question first requires a brief explanation of why residual data exists.

With respect to computers, the term ``deleted'' does not mean destroyed. Rather, when a file is deleted, the computer makes the space occupied by that file available for new data. Reference to the deleted file is removed from directory listings and from the file allocation table, but the bits and bytes that make up the file remain on the hard drive until they are overwritten by new data, or ``wiped'' through the use of utility software. The result is that a file ``appears'' to have been deleted, but may still be recovered from the disk surface.

Residual data includes deleted files, fragments of

deleted files and other data that is still extant on the disk surface. To assure that this residual data is captured, you must make what is known as an ``image copy" of the target drive. An image copy duplicates the disk surface sector by sector, thereby creating a mirror image of the target drive. In contrast, a file-by-file copy (what is made when you simply select the files you want copied) captures only the data contained in the specific files selected. Even if all files are selected, a file-by-file copy will not capture any residual data.(3)

8. Write protect and virus check all media. Now that you have obtained the data, how do you look at it? You likely have a mix of image copies, backup tapes, diskettes, CDs and other media. Before doing anything else, you must maintain the integrity of the media you have received. The two key steps in doing this are write protection and virus checking.

Write protecting prevents data from being added to the media, guaranteeing that the evidence you gather is not altered or erased when you are working with it. You should write protect all media before doing anything else with it.

Similarly, virus checking prevents evidence from being altered and is the second thing you should do with all media. The key is to use up-to-date virus checking software. If a virus is detected, record all information about it and immediately notify the party producing the media. Do not take steps to clean the media, as doing so will change the evidence that was produced.

9. Preserve the chain of custody. A chain of custody tracks evidence from its original source to what is offered as evidence in court. With electronic evidence, a chain of custody is critical because the data can be altered relatively easily.

Preserving a chain of custody requires, at a minimum, proving that: (a) no information has been added or changed; (b) a complete copy was made; (c) a reliable copying process was used; and (d) all media was secured. Write protecting and virus checking all media are the key steps in meeting the first requirement; making image copies is the key to meeting the second.

A reliable copy process has three critical characteristics. First, the process must meet industry standards for quality and reliability. This includes the software used to create the copy and the media on which the copy is made. A good benchmark is whether the software is used and relied on by law enforcement agencies. Second, the copies must be capable of independent verification. In short, your opponent and the court must be able to satisfy themselves that your copies are accurate. Third, the copies created must be tamper

when electronic records are altered or destroyed. See *Computer Assoc. Internat'l v. Am Fundware*, 135 F.R.D. 166 (D. Colo. 1990); *Nat'l Assoc. of Radiation Survivors v. Turnage*, 115 F.R.D. 543 (N.D. Cal. 1987). Sanctions may be imposed even when the alteration or destruction occurs in the regular course of business. The common thread in the cases imposing sanctions is the fact that the party altering or destroying its computer records was on notice that such records were relevant to pending or threatened litigation.

(3) When collecting computer data for evidentiary purposes, a party has a duty to "utilize the method which would yield the most complete and accurate results." *Gates Rubber Co. v. Bando Chemical Indus. Ltd.*, 167 F.R.D. 90, 112 (D. Colo. 1996). In *Gates*, the court criticized the plaintiff for failing to make image copies and for failing to preserve undeleted files properly.

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